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Nos. 97-826, 97-829, 97-830 and 97-83

IN THE
Supreme Court of the United States
October Term, 1997

AT&T CORP., *et al.*,
Petitioners,
v.
IOWA UTILITIES BOARD, *et al.*,
Respondents,

AT&T CORP., *et al.*,
Petitioners,
v.
CALIFORNIA, *et al.*,
Respondents.

AND RELATED PETITIONS

On Petitions for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF IN OPPOSITION

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December 18, 1997

**The respondent GTE Entities are listed on inside cover.*

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This Brief in Opposition is filed on behalf of the following GTE Entities as respondents:

GTE Service Corporation
GTE Alaska Incorporated
GTE Arkansas Incorporated
GTE California Incorporated
GTE Florida Incorporated
GTE Midwest Incorporated
GTE South Incorporated
GTE Southwest Incorporated
GTE North Incorporated
GTE Northwest Incorporated
GTE Hawaiian Telephone Company Incorporated
GTE West Coast Incorporated
Contel of Minnesota, Inc.
Contel of the South, Inc.

QUESTIONS PRESENTED

1. Did the Court of Appeals err in concluding that the plain terms of the Telecommunications Act of 1996 leave pricing determinations under the local competition provisions of the Act to state public utility commissions, rather than the FCC?

2. Did the Court of Appeals err by interpreting 47 U.S.C. § 251(c)(3), which requires incumbent telephone companies to provide network elements to requesting carriers "in a manner that allows requesting carriers to combine such elements," as requiring requesting carriers, rather than incumbents, to undertake the burden of combining elements in order to provide telephone service?

3. Did the Court of Appeals err in vacating the FCC's rule implementing 47 U.S.C. § 252(i), which provides that an incumbent telephone company must "make available any interconnection, service, or network element provided under an agreement . . . to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement," where the FCC's rule would have allowed requesting carriers to pick and choose individual terms from other agreements without accepting all of the trade-offs that had produced those terms?

RULE 29.6 STATEMENT

Pursuant to Supreme Court Rule 29.6, the GTE Entities advise the Court that each of the GTE Entities listed inside the front cover of this brief is a subsidiary of GTE Corporation. In addition, GTE Corporation has the following subsidiaries or affiliates that have outstanding securities in the hands of the public:

BC TELECOM, Inc.
BBN Corporation
Cable-Axion Digitel Inc.
Cable-Axion Quebec Inc.
Caribbean Reservation Center, C. por A.
Communications Telefonicas, C. por A.
Conagro Telecommunications, S.A.
CTI Compania de Telefonos del Interior S.A.
CTI North Compania de Telefonos del Interior S.A.
Digital Courier International Inc.
GTE California Incorporated
GTE Directories Corporation Ltd.
GTE Florida Incorporated
GTE Hawaiian Telephone Company Incorporated
GTE Leasing Corporation
GTE Midwest Incorporated
GTE Mobilnet of Florence, Alabama Incorporated
GTE Mobilnet of Jacksonville Incorporated
GTE Mobilnet of Jacksonville II Incorporated
GTE Mobilnet of Wilmington Incorporated
GTE Mobilnet of Wilmington II Incorporated
GTE North Incorporated
GTE Northwest Incorporated
GTE South Incorporated
GTE Southwest Incorporated
GTE Yellow Pages Hungary Kft

RULE 29.6 STATEMENT
(continued)

La Compagnie de Telephone Anglo-Canadienne/Anglo-Canadian Telephone Company
MTX Italia
Parque Industrial ITABO, S.A.
Quebec-Telephone
Radiowealth, Inc.
The Micronesian Telecommunications Corporation
Zona France Las Americas

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STATEMENT

In their petitions, the FCC and the long-distance companies attempt to paint the States as guardians of monopolies designed to deprive American consumers of the benefits of affordable telephone service. That claim is a gross distortion, and correcting it makes it even clearer why, as the Eighth Circuit held, Congress expressly assigned jurisdiction over the pricing provisions of the Telecommunications Act of 1996 to the States, not the FCC.

A. Regulation Prior to the Telecommunications Act of 1996.

For decades prior to the passage of the Telecommunications Act of 1996, the provision of local telephone service was regulated by the States as a natural monopoly. The capital investment required to build a telephone network connecting every home and business in a given area was so vast that it made sense economically for only one company to construct and operate such a local exchange network. As a result, state public utility commissions regulated local telephone companies ("local exchange carriers" or "LECs") through a system of exclusive franchises.

Through the prior exclusive franchise system, the States and the LECs built and extended to all Americans the finest local telecommunications network in the world at affordable rates. The provision of basic service to all who desire it at affordable rates is known as "universal service." The exclusive franchise system was key to the success of universal service in two ways. First, it enabled the States to encourage LECs to make the enormous investment needed to construct and upgrade first-rate networks and to extend them to all Americans, however remote their location. Second, it was the central pillar of an elaborate system of intercustomer subsidies that has kept rates for basic residential service extremely low.

For example, under the rates typically approved by State utility commissions, most everyday residential customers pay well below the full cost of providing them with basic service, and business customers pay well in excess of cost. Thus, among other intercustomer subsidies, businesses subsidize the local residential telephone service of most American citizens.

This background is relevant because now that local telephone service has been opened up to plenary competition, this subsidy system (and the low-cost residential universal service that it guarantees) is not sustainable in its current form. If new entrants are allowed to "cherry pick" high-revenue, low-cost business customers without paying their fair share of the costs of subsidizing low-cost service to all residents who desire it, the subsidy system, and the affordable universal service that it supports, will collapse. Congress knew this, and therefore (as we explain below), in the Telecommunications Act of 1996 placed the power to establish just and reasonable prices for services and facilities that a competitor purchases from the incumbent LEC in the hands of the State public utility commissions, who not only have traditionally regulated in this area, and thus have expertise in determining individual LECs' costs, but who also are in a much better position to ensure that competition is introduced in a manner that will preserve, not destroy, universal service.

B. Introduction of Competition By the States and The Telecommunications Act of 1996.

To read the petitions of the FCC and the long-distance companies, one would think that Congress, in the 1996 Act, dragged the States into the new world of competition. That impression is false.

The reality is that many States were well ahead of Congress in opening the markets for local telephone service to competition. By the early 1990s, advancing technology (particularly advances in wireless communication and the

pervasive presence of cable television wiring in almost every home in many areas) had made the possibility of competition in local telephony a reality. Acting on these advances, many States began in the early 1990s, before Congress, to open up the markets for local telephone service to competition.[1] In the 1996 Act, Congress essentially codified at the national level the trend that was already well underway in the States -- rejecting the view that local service continued to be a natural monopoly.

Indeed, the 1996 Act provides what Congress characterized as a "pro-competitive, *de-regulatory*" framework for opening to competition both the local and long-distance markets for telephone service. Joint Explanatory Statement of the Committee of the Conference, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. 113 (1996) (emphasis added). With respect to local telephone service, the Act seeks to promote a rapid transition to competition in part by imposing three duties on incumbent LECs. First, the Act requires an incumbent LEC to allow other carriers to interconnect with its network so that the new entrants can connect calls from their own customers to customers served by the incumbent LEC's network. *See* § 251(c)(2). Second, the Act requires an incumbent LEC to offer for resale at wholesale rates any telecommunications service that the LEC provides to retail customers. *See* § 251(c)(4). Third, the Act requires an incumbent LEC to allow competitors to purchase on an "unbundled basis" individual pieces, or "elements," of the LEC's network (such as the switch or the wire to a customer's house), so that the new entrants may "combine such elements in order to provide . . . telecommunications service." *See* § 251(c)(3).

To implement these provisions while at the same time preserving the Act's stated goal of "reduc[ing] regulation,"

[1] *See, e.g.*, Notice of Proposed Rulemaking, CC Docket No. 96-98, 61 Fed. Reg. 18311, 18314 (Apr. 25, 1996) (noting that by 1996, nineteen States had already begun to open local service to competition).

Pub. L. No. 104-104 Preamble (1996), Congress crafted a system that relied on private negotiations between incumbent LECs and other carriers, backed up by binding arbitrations conducted by state public utility commissions. Thus, an incumbent LEC has a duty under the Act to "negotiate in good faith" to reach agreements allowing competitors to use its network, *see* § 251(c)(1), and agreements reached by such private negotiations are explicitly freed from many of the specific requirements of the Act, *see* § 252(a). If the parties fail to reach a private agreement, the Act calls upon state utility commissions to resolve open issues in binding arbitrations. *See* § 252(b).

In particular, the Act expressly assigns the States the role of determining, in arbitrations, the prices for interconnection, network elements, and wholesale services. Thus, the Act provides that in arbitrations, "a *State commission* shall . . . establish any *rates* for interconnection, services, or network elements *according to subsection (d)*" of section 252. § 252(c)(2) (emphasis added). Section 252(d), which is entitled "PRICING STANDARDS," then spells out the standards state commissions must follow in establishing those rates. With respect to interconnection and network elements, section 252(d)(1) provides that "[d]eterminations by a *State commission* of the just and reasonable rate . . . shall be . . . based on the cost . . . of providing the interconnection or network element . . . and . . . may include a reasonable profit." § 252(d)(1) (emphasis added). With respect to services, section 252(d)(3) provides that "*a State commission* shall determine wholesale rates on the basis of retail rates . . . excluding the portion thereof attributable to any . . . costs that will be avoided by the local exchange carrier" by selling at wholesale rather than retail. § 252(d)(3) (emphasis added).

The Act also gives some role to the FCC in implementing local competition, albeit not jurisdiction over prices. For example, § 251(e) authorizes the FCC to designate an entity "to

administer telecommunications numbering and to make such numbers available on an equitable basis." *See also* § 251(b)(2) (giving the FCC a role in defining duties to implement number portability); § 251(b)(4) (access to rights of way).

To ensure that the Act would be implemented swiftly, Congress imposed strict deadlines on the state commissions and the FCC. With respect to the state commissions, section 252(b) requires a state commission to conclude arbitrations "not later than 9 months after" a competing carrier first requests interconnection, network elements or services. § 252(b)(4)(c). With respect to the FCC, § 251(d) directed the FCC to complete all necessary actions to issue regulations implementing its tasks under section 251 "[w]ithin 6 months after the date of enactment" of the Act. § 251(d)(1).

C. The FCC's First Report and Order.

The process established by Congress for introducing local competition got underway immediately after passage of the Act in February 1996. Private negotiations started promptly and, under timetables set in the Act, state commissions soon began arbitrating agreements. In short, as the Court of Appeals later explained in entering a stay of the FCC's pricing rules, "[t]he Act's system of private negotiation backed by state-run arbitration was operating without the input from the FCC" to speed the transition to competition and had "initially proved to be successful." *Iowa Utilities Board v. FCC*, 109 F.3d 418, 427-28 (8th Cir. 1996).

On August 8, 1996, however, the FCC announced its First Report and Order[2] and threatened to derail that process entirely. While purporting to implement the *de-regulatory* mandates of the Act, the FCC instead produced a mammoth 700-page Report and Order that replaced the process Congress

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[2] In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 (Aug. 8, 1996).

envisioned for fostering competition -- a system of private negotiations backed by localized state arbitrations -- with an exhaustive national code purporting to dictate virtually every aspect of the terms the States were to impose in arbitrations.

In particular, the FCC set specific so-called "proxy prices" to be used in the ongoing arbitrations. The FCC declared that the States *must* use these proxy prices unless they first completed cost studies based on a pricing methodology described for the first time in the FCC's order. *See* First Report and Order ¶ 619 (App. 1a).

In addition, the FCC claimed plenary authority to dictate to the States exactly what costs they could and could not consider in setting rates. *First*, the First Report and Order prohibited States from even considering the actual historical costs of constructing an incumbent LEC's network. Instead, the FCC commanded that all States must set prices based only on forward-looking costs -- specifically on what the FCC termed total element long-run incremental cost ("TELRIC"). *See* First Report and Order ¶¶ 705-06 (Pet. App. 250a-252a). *Second*, the FCC even prohibited States from considering a LEC's own forward-looking costs -- *i.e.*, the prospective costs an incumbent LEC would actually incur in operating its own network. Instead, the FCC purported to require all States to set prices based on a nonexistent *hypothetical network* that used only the most efficient technology available. *See id.* ¶ 685 (App. 8a). *Third*, even as to the FCC's hypothetical forward-looking costs, the First Report and Order sharply limited the joint and common costs that a LEC could recover, *see id.* ¶ 696 (App. 8a-9a), effectively ensuring that a LEC would not be able to recover most of its joint and common costs.

The FCC also promulgated a series of rules radically expanding the unbundling obligation imposed by the Act. The FCC concluded that a new entrant could provide service solely through the purchase of all the elements of an incumbent's network. *See* First Report and Order ¶¶ 328-334 (Pet. App.

242a-246a). At the same time, the agency ruled that an entrant could obtain these elements already pre-assembled into a finished package of local service -- the entrant would not have to do any "combining" of elements whatsoever. *See* 47 C.F.R. § 51.315(b), (c) (Pet. App. 294a).

This so-called "sham unbundling" rule (together with the hypothetical TELRIC pricing rules) threatened to undermine the system of universal service that Congress was so careful to preserve during the transition to competition. In setting the statutory standard for the price of wholesale services, Congress was careful to require new entrants to contribute towards the subsidization of residential universal service by requiring State commissions to set wholesale prices at the LEC's retail rates (which, for high-revenue customers, include a margin that contributes to universal service) minus only those costs that the LEC will avoid by selling at retail instead of wholesale.[3] By allowing competitors to purchase all of the network elements necessary to provide local service already combined into the local service and not unbundled, the FCC effectively gave behemoth companies like AT&T and MCI a blueprint for undermining universal service and pocketing for themselves, through simple regulatory arbitrage, the very subsidies that keep residential service affordable. Either the competitor could call its purchase a purchase of local *service* -- in which case it would be required to contribute toward the subsidization of universal service through the LEC's wholesale rates -- or it could *relabel* that same purchase as one for all of the incumbents' network elements already combined together -- in which case the competitor could purchase the same service for

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[3] Indeed, Congress explicitly recognized that such a pricing standard was necessary to protect existing subsidies in the LEC's rates. *See, e.g.,* H.R. Rep. No. 204, 104th Cong., 1st Sess., pt. 1, at 72 ("The [resale] rate should reflect whether, and to what extent, the local dialtone service is subsidized by other services . . . .").

a fraction of the wholesale cost of the service[4] and avoid making any contribution to universal service.[5]

D. Review in the Eighth Circuit.

Numerous parties filed petitions for review of the FCC's First Report and Order and the cases were consolidated in the United States Court of Appeals for the Eighth Circuit. The States of Iowa, Florida, Louisiana, and South Dakota, as well as GTE and other telephone companies, immediately sought a stay, at a minimum, of the FCC's pricing rules. After convening a special oral argument, the Court of Appeals stayed the FCC's pricing rules and expressly found that the States and other movants were likely to prevail on their claim that under the plain terms of the Act the FCC lacked jurisdiction to promulgate rules implementing the pricing terms of the Act. *See Iowa Utilities Board v. FCC*, 109 F.3d 418, 423-25 (8th Cir. 1996). The Court also found that the FCC's pricing rules would cause both the parties seeking the stay and the process set up by Congress for implementing the Act immediate and irreparable harm. *Id.* at 425-26.

At the merits stage, the parties re-briefed the issues of statutory construction that had been raised on the motions for

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[4] AT&T's president touted to analysts that buying elements provides "another way to resell" service, but at a discount of "52 percent," as opposed to the statutory resale discounts which have been set in the range of 15-25 percent. *See* Transcript, "AT&T Investment Community Meeting" (March 3, 1997).

[5] While section 254(f) of the Act plainly commands that "every telecommunications carrier that provides intrastate telecommunications services *shall contribute*, on an equitable and nondiscriminatory basis . . . to the preservation and advancement of universal service," 47 U.S.C. § 254(f), the FCC made it clear that under its plan for implementing the pricing terms of the Act, in the critical period of transition to competition, new entrants would be allowed to purchase network elements at prices that failed to reflect universal service costs long *before* States had established new mechanisms for spreading the burden of universal service.

stay, and addressed additional issues as well. After considering several hundred pages of briefs and hearing three hours of oral argument, the Eighth Circuit adhered to its initial conclusion that the plain terms of the Act denied the FCC any authority over implementing the pricing provisions of the Act. The Court also vacated several further provisions of the FCC's rules. Three of the Court's decisions are most relevant to the questions raised in the petitions for *certiorari*.

First, applying standard principles of construction, the Court turned to the text of the Act to determine whether Congress had given the FCC authority to promulgate rules concerning the pricing terms for the local competition provisions. The Court found that section 252(c)(2) expressly directs state commissions, not the FCC, to establish rates in arbitrations conducted between new entrants and incumbents. Moreover, section 252(d) spells out the standards the state commissions are to apply. Examining the Act as a whole, the court concluded that "the Act plainly grants the state commissions, not the FCC, the authority to determine the rates involved in the implementation of the local competition provisions of the Act." Pet. App. 14a.

Alternatively, the Court explained that *even if* the text of section 252 were not clear, any ambiguity was resolved by section 2(b) of the Communications Act, which provides that "nothing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." 47 U.S.C. § 152(b). The Court noted that the rates incumbents could charge for opening their networks to competing providers of local exchange service were charges "for or in connection with intrastate communications service" and reasoned that under settled law, the restriction of section 2(b) barring the FCC from authority over such matters could only be overcome by a straightforward and unambiguous command

from Congress. *See* Pet. App. 15a-19a (citing *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355 (1986)). But far from providing any unambiguous grant of authority to the FCC, the 1996 Act straightforwardly assigned the task of implementing the pricing standards of the Act to the States. The rule of section 2(b) thus confirmed the Court's construction of the plain terms of section 252.

Second, the Court addressed the scope of incumbent LECs' unbundling duties under the Act. GTE and other incumbents had argued that new entrants should not be permitted to provide local service wholly through the use of unbundled elements. Given that the FCC and most States had interpreted the pricing standards for unbundled elements and for services in a way that excluded historical, subsidy and other relevant costs, and thus made it substantially cheaper to buy all the elements of the network from end to end rather than to buy services at wholesale, GTE argued that it made no sense to allow entrants effectively to obtain the incumbent's own service for resale through the fiction of labeling their purchase as one of unbundled elements.

Rejecting the full scope of GTE's position, the Eighth Circuit ruled that entrants could provide service solely by purchasing all network elements. In other words, they could buy the entire network from end to end as elements and provide service solely over the incumbent's facilities. The Court emphasized, however, that it was critical to its analysis that under the terms of section 251(c)(3), new entrants would have to shoulder the burden of combining elements themselves. As the Court explained, the costs and risks that new entrants would have to bear in combining elements would ensure that the purchase of network elements and the purchase of finished service would remain separate methods of entry. The Court thus vacated a series of FCC rules requiring incumbent LECs to undertake the task of combining elements at new entrants' request. In its initial opinion, however, the Court without

comment left in place one rule, 47 C.F.R. § 51.315(b), that required incumbent LECs to provide entrants with elements already pre-assembled into a fully functioning package if the elements were already connected in the LEC's own network.

In a petition for rehearing, GTE and other parties pointed out that the failure to vacate this rule would fatally undermine the Court's rationale for allowing entrants to purchase all the network elements required to provide finished service. If an entrant could purchase elements already pre-assembled, it would face none of the additional costs and risks that the Court had identified and would, in effect, simply be obtaining finished service for resale, but at a lower price that undermined the system of universal service. The Eighth Circuit agreed and specifically vacated section 51.315(b). The Court explained that its ruling was critical for preserving a coherent reading of the Act, for to "permit such an acquisition of already combined elements at cost based rates for unbundled access would obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4) between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other." Pet. App. 71a.

Third, the Court vacated the FCC's rule purporting to implement section 252(i). Under that section, incumbents must "make available any interconnection, service, or network element provided under an agreement . . . to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement." The FCC concluded that under this provision an entrant could pluck out from any other agreement solely the terms that applied to a single service or network element without having to accept any other provisions of the agreement -- even if terms on another matter had been the critical *quid pro quo* that made the favorable term selected by the entrant possible. The Court of Appeals recognized that this construction would render

unworkable the process of private negotiations that Congress had outlined as the primary means of implementing the Act. Incumbents could not realistically engage in a free give-and-take in bargaining if new entrants would always remain free to jettison selected portions of their agreements and to pick and choose the most favorable terms obtained by other carriers as replacements. The Court thus vacated the FCC's "pick and choose" rule as an unreasonable construction of the Act.

REASONS FOR DENYING THE WRIT

SUMMARY

None of the three separate issues raised by the petitions for certiorari warrants review by this Court.

1. The Eighth Circuit's ruling that the FCC lacks jurisdiction to impose pricing rules on the States does not merit review in this Court for several reasons.

First, the petitions for review largely ignore the actual holding below -- which rested on the 1996 Act's *express* assignment of pricing authority to the States. Only by ignoring this holding, which involves only a straightforward application of settled principles of statutory construction, can petitioners attempt to suggest that this case raises more far-reaching issues concerning the jurisdiction of the FCC. In addition, as explained below, the holding below is plainly correct.

Second, petitioners' attempt to concoct a circuit split out of the Court of Appeals' alternative reasoning based on section 2(b) of the Communications Act fails for at least three separate reasons. First, the theory on which petitioners rely in this Court -- that, despite section 2(b), the FCC has jurisdiction because the local telephone network is used inseverably for both intrastate and interstate communications -- was *not* the basis upon which the agency asserted jurisdiction in the First Report and Order. Under settled principles of administrative law, that rationale cannot now provide a basis for second-guessing the Court of Appeals. Second, the Court of Appeals

explicitly held that, because the 1996 Act expressly assigned jurisdiction to the States, it was not necessary to rest its decision on whether the services in question were intrastate or interstate in nature and on how that might affect the application of section 2(b). Third, the Eighth Circuit's decision cannot possibly conflict with the decisions of other circuits interpreting section 2(b) for the additional reason that none of the cases cited by petitioners involved an express statutory assignment of jurisdiction to the States.

Third, while important at the time (because it stayed the FCC's arbitrary proxy prices), the Eighth Circuit's jurisdictional decision has had no real impact on the substantive pricing rules that have been imposed on LECs, because, as FCC Commissioners have repeatedly proclaimed, virtually every State has adopted a substantive pricing approach similar to that adopted by the FCC. Revisiting and reversing the Eighth Circuit's jurisdictional holding would only lead to delays from further rounds of litigation and, by the FCC's own admission, could accomplish little substantive change in the pricing approach the States have applied.

2. Nor is it appropriate to grant certiorari to review the Court of Appeals' decision that incumbent LECs cannot be required to provide competitors with unbundled network elements already preassembled into finished telephone service.

First, the Eighth Circuit's decision on this issue is plainly correct. It would be contrary to the plain language of the statute, and would undermine the entire structure of the Act, if a competitor were allowed to evade the wholesale pricing standards established by Congress merely by *relabeling* its purchase of local service as the purchase of all the network elements necessary to provide that service already preassembled into a finished package. Congress did not intend to allow an entrant to purchase local service at roughly half the cost of wholesale service and to avoid its obligation to contribute toward the provision of universal service merely by

relabeling its purchase of service as the purchase of all the elements of a LEC's network already bundled together.

Second, granting certiorari on this question would require the Court also to delve into at least two additional questions that are inextricably intertwined with the issue on which petitioners' seek review and that the Court of Appeals decided *in petitioners' favor*. Specifically, the questions of (i) what parts of a LEC's business constitute "network elements," and (ii) whether a competitor can purchase *all* of the elements necessary to provide finished telephone service, are inextricably linked with the Court of Appeals' decision that a LEC, while required to provide a competitor with all network elements, need not provide them already preassembled into finished telephone service. It would be unfair, and would result in an incoherent interpretation of the 1996 Act, for the Court to attempt to address the Court of Appeals' invalidation of section 51.315(b) of the First Report and Order without also addressing these other issues. The Court simply cannot wade halfway into the complex telecommunications issues presented by this case. While we believe that the Court should not reopen any of these issues that consumed hundreds of pages of briefing below, we intend to file promptly a conditional cross-petition raising those issues that are intertwined with the nonjurisdictional unbundling issues raised by the petitions.

3. Finally, the Court of Appeals' decision invalidating the FCC's "pick and choose" interpretation of section 252(i) of the Act is plainly correct and involves only the most fact-bound application of settled rules of statutory construction. It is in no event worthy of review by this Court.

I. The Eighth Circuit's Ruling that the FCC Lacks Jurisdiction To Impose Its Pricing Theories on the States Was Plainly Correct And in Any Event Involves Only Settled Principles of Statutory Construction.

A. The Eighth Circuit Correctly Determined That the Plain Terms of the Act Assign the States the Task of Implementing the Pricing Terms of the Act.

The petitions for certiorari largely ignore the actual holding below, which rested on the express assignment of pricing authority to the States in section 252. Instead, they focus their attacks on the Court's alternative analysis under section 2(b). That tactic is hardly surprising, for a review of the terms of section 252 readily demonstrates that Congress straightforwardly assigned authority over pricing to the States, and that nothing in the ruling below merits this Court's review.

As the Eighth Circuit explained, section 252(c) commands the "State commission[s]" to "establish any rates for interconnection, services, or network elements," and it requires them to follow only the standards outlined in subsection 252(d).[6] Section 252(d), a section entitled "Pricing Standards," provides the specific substantive standards the States are to apply, "thus negating the need for additional FCC-mandated ratemaking standards or guidelines." Pet. App. 14a.[7]

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[6] Congress addressed any concerns that might be raised under the Tenth Amendment by ensuring that States could opt out of their role under the Act. *See* 47 U.S.C. § 252(e)(5).

[7] Contrary to the claims of petitioner MCI, the decision below raises no constitutional concern that federal lawmaking authority has been delegated to the States. MCI attempts to manufacture such a problem by grossly misquoting the opinion to suggest that state commissions would be "'dictat[ing] the substantive standards'" under the Act. *See* MCI Pet. at 26. The passage cited actually states simply that Congress had *not* intended *the FCC* to be "in a position to dictate the substantive standards governing the

(continued...)

The absence of any role for the FCC in pricing is confirmed by the structure of section 252(c). In defining States' obligations for conducting arbitrations, that section creates a clear dichotomy. Section 252(c)(1) makes it plain that in imposing terms on subjects over which the FCC has some rulemaking authority under section 251, States must ensure that those terms meet *both* "the requirements of section 251" *and* "the regulations prescribed by the Commission pursuant to section 251." In sharp contrast, in the very next paragraph, the Act addresses the States' role in setting prices as a separate matter and -- omitting any reference to FCC rules -- commands solely that "a state commission shall . . . establish rates for interconnection, services, or network elements according to subsection [252](d)." As the Court of Appeals explained in entering its stay of the FCC's pricing rules, the contrast between section 252(c)(1) and section 252(c)(2) makes it plain that "where Congress intended for the state commissions to follow FCC rules in arbitrations, it expressly said so." 109 F.3d at 424.

In short, the Eighth Circuit was correct in concluding that "the absence of any reference whatsoever to the FCC in the sections of the Act that directly authorize the state commissions to establish prices confirms to us that Congress did not envision the FCC's participation in determining prices." Pet. App. 13a.

The Eighth Circuit also rightly concluded that *even if* there were some ambiguity in the terms of section 252, section 2(b)

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[7] (...continued)
[rural] exemption process." Pet. App. 30a. A restriction on the FCC in implementing the rural exemption provisions of the Act in no way suggests that States have been granted federal lawmaking authority, and it certainly has no bearing on the States' role under the provisions MCI purported to be addressing -- the pricing provisions. Relying on state agencies to apply the pricing standards spelled out in the Act through quasi-adjudicative arbitrations raises no constitutional concerns whatsoever.

of the Communications Act would preclude FCC jurisdiction over pricing. Section 2(b) provides that "nothing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." 47 U.S.C. § 152(b). As this Court has pointed out, section 2(b) is a "congressional denial of power to the FCC" that "fences off" intrastate matters from FCC control. *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 370, 374 (1986). This restriction on the FCC can be overcome only if Congress includes "unambiguous" and "straightforward" language in the Act either modifying section 2(b) or expressly granting the FCC additional authority. *Id.* at 377. Here, the provisions of the Act allowing new entrants access to incumbents' networks so that they may provide competing local telephone service clearly address predominantly intrastate matters. Yet the FCC cannot point to either exception to section 2(b). There is no "unambiguous" grant of authority to the FCC over pricing, nor did Congress amend section 2(b) to exempt the local competition provisions from its operation.

The FCC's strained attempts to find unambiguous language supplying its claimed authority over pricing are of no avail. The FCC first points to section 251(d)(1), which provides only that the FCC must promulgate any regulations implementing section 251 within 6 months of the date of enactment. But even the FCC tacitly acknowledges that section 251(d) provides no clear grant of rulemaking authority over pricing as it equivocates between calling the section a "grant" and a "confirmation" of authority. *See* FCC Pet. at 12. Such a provision that appears to *assume* an unspecified measure of rulemaking authority conferred upon the FCC elsewhere can hardly override the express delegation to the States of authority over *pricing* in section 252(d). Indeed, the section cannot possibly grant authority over pricing, for to the extent it implies any authority at all, it refers only to rules to

"implement the requirements of *this section*."[8] (Emphasis added). But it is plainly section 252, not section 251, that provides the pricing standards under the Act. The FCC can only pretend that section 251 "prescribes a set of new federal standards to govern . . . the prices that incumbent[s] . . . may charge competitors," FCC Pet. at 11, by studiously ignoring the section that by its terms actually addresses "Pricing Standards" -- that is, section 252(d).

Nor can the FCC or its supporters rely on the fact that section 251(c)(3), in defining the duty to provide unbundled elements, requires that elements be provided on "rates, terms, and conditions that are just [and] reasonable," to claim that the FCC must have authority to implement the "rate provisions of Section 251(c)." FCC Pet. at 15. The mere reference to "just and reasonable" rates in section 251(c) cannot provide the FCC the authority it purported to exercise in issuing its exhaustive pricing regulations. To the contrary, in outlining its forward-looking cost methodology, the FCC explicitly sought to implement the cost-based pricing standard that *State commissions* were directed to apply under section 252(d). *See* First Report and Order ¶¶ 628, 630-633 (App. 2a-7a). Pointing now to section 251(c)'s "just and reasonable" language thus cannot possibly justify the FCC's rules.

Next, the FCC and other petitioners point to general grants of rulemaking authority elsewhere in the Communications Act of 1934. For example, the FCC relies on the last sentence of section 201(b). The Eighth Circuit rightly concluded, however, that this grant of authority is limited to interstate matters. Section 201(a) is expressly limited to "interstate or foreign communication by wire or radio," and section 201(b) begins by making it plain that it is addressing "such communication service" -- that is, the same interstate or foreign communication

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[8] Similarly, section 252(c) refers to state commissions following FCC rules promulgated only under section 251. *See* § 252(c)(1).

addressed in section 201(a). The FCC's claim that the last sentence of the section is somehow freed from the same restriction blithely ignores everything that comes before. In any event, any grant of general rulemaking authority in the 1934 Act cannot override Congress's express assignment to the States of authority over the specific pricing terms of the local competition provisions of the 1996 Act. That result follows ineluctably from the long-settled canon of construction that specific terms trump the general. *See, e.g.*, *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384-85 (1992).

At bottom, the FCC and its supporters rest their arguments on the assumption that it would be inconceivable that the federal Act could ever apply to a subject without simultaneously giving the FCC rulemaking authority. Nothing in the text of the Act, however, dictates that the FCC's authority must follow wherever Congress has applied federal law, especially where Congress has specifically assigned authority for implementing certain provisions of the Act to state commissions.[9]

B. The Eighth Circuit's Decision Does Not Create Any Circuit Conflict Concerning the Application of Section 2(b).

Petitioners next claim that the Eighth Circuit's decision creates a conflict among the circuits concerning the application of section 2(b). That assertion is false for at least three independent reasons.

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[9] The question of authority over dialing parity rules that was addressed in the Eighth Circuit's ruling on the Second Report and Order does not raise any fundamentally different analysis. There too, the plain terms of the Act indicate State control, *see, e.g.*, 47 U.S.C. § 271(e)(2)(B) (indicating that States may issue orders requiring toll dialing parity), and in any event, the FCC can point to no unambiguous grant of authority to overcome section 2(b).

First, the so-called "inseverability" analysis on which the FCC now relies to support its claimed authority over pricing formed no part of the agency's rationale for its jurisdiction when it issued the First Report and Order. *See* First Report and Order ¶¶ 83-103, 111-120 (Pet. App. 190a-202a, 210a-215a). Under settled principles of administrative law, this new-found theory cannot serve as a basis for second-guessing the Court of Appeals' decision now. *See SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947). In any event, inseverability analysis could never justify the broad authority the FCC has claimed -- an authority that includes the power to set wholesale rates for wholly *intra*state local telephone service. There is no plausible basis for claiming that allowing the States authority to set such wholesale rates for local service would negate the FCC's ability to regulate *inter*state communications.

Second, and equally importantly, petitioners flatly misread the decision below. Petitioners claim that the Eighth Circuit rested its jurisdictional holding critically on the conclusion that section 2(b) denies the FCC authority because the local competition provisions address services that are "fundamentally intrastate" in nature. According to petitioners, that reasoning supposedly conflicts with the decisions holding that where equipment is used to provide both interstate and intrastate service, and the FCC cannot successfully regulate the interstate aspects of the equipment's use as a separate matter, the FCC may regulate *both* interstate and intrastate uses of the equipment. *See, e.g.*, FCC Pet. at 19. According to petitioners, other circuits would have recognized that the local exchange is used to provide both interstate and intrastate services and on that basis would have granted the FCC's claimed authority over all pricing under the Act.

The central flaw in petitioners' argument is that the Eighth Circuit did not, as petitioners suggest, rest its decision primarily on section 2(b). To the contrary, as outlined above, the Court relied on the plain terms of the Act, which "directly

and straightforwardly assig[n] to the States the authority to set the prices regarding the local competition provisions of the Act." Pet. App. 17a. The Court went on to address section 2(b) only to demonstrate that *even if* the text of section 252 were not so clear, any ambiguity would still have to be resolved by assigning control over pricing to the States. Characterizing the services covered in the local competition provisions as intrastate or interstate thus formed no essential part of the Court's holding. Indeed, the Court even took pains to make it clear that "subsections 252(c)(2) and 252(d) clearly assign jurisdiction over the rates for the local competition provisions of the Act to the state commissions, *thus avoiding the need to analyze the interstate/intrastate character of these services*." Pet. App. 22a (emphasis added). The decision cannot create a circuit conflict concerning the application of the so-called "inseverability" exception to section 2(b) when the Court made it clear that the entire analysis under section 2(b) was only an alternative rationale for its result.

To the extent the Court below did point out that "*even* a traditional analysis of the interstate/intrastate quality of the local competition provisions of the Act reveals that these functions . . . are fundamentally intrastate in character," Pet. App. 22a (emphasis added), it was providing reasoning in the alternative that was not essential to its holding. Petitioners' attempt to seize upon this dicta as the critical basis for a purported circuit conflict, *see, e.g.*, FCC Pet. at 19; AT&T Pet. at 13, is nothing but an effort to manufacture an illusory dispute and cannot justify review by this Court.

Third, because the Act straightforwardly assigns the States the task of implementing the pricing provisions, this case is readily distinguishable from those in which inseverability analysis has been applied to extend FCC jurisdiction over intrastate matters. Indeed, the Eighth Circuit distinguished many of the very cases petitioners cite on precisely that basis. *See* Pet. App. 21a.

C. The Eighth Circuit's Ruling Implementing the Balance of Authority Specified By Congress in No Way Impedes the Implementation of the Act.

Petitioners finally attack the Eighth Circuit's decision on the grounds that, in their view, by depriving the FCC of absolute authority to dictate national pricing rules, it makes the implementation of the Act, and the advent of competition, impossible. In reality, however, it is further review of the FCC's jurisdictional claims that would lead to delay.

In part, petitioners suggest that uniformity is critical to the success of the Act. But throughout the petitions there is also an undercurrent suggesting something more sinister in allowing the States an independent role in applying the terms of the Act to local conditions. Petitioner MCI brazenly makes its mistrust explicit as it charges the States with "complicity . . . in past monopolistic local markets" and exclaims that, given their "complicity," "Congress kept state commissions on a short leash" in performing any role under the Act. MCI Pet. at 7.

Contrary to such wild claims, the terms of the Act make it plain that Congress intended the States to play a vital and independent role in implementing critical terms of the Act. While the FCC and its supporters see any variation in the application of the Act as a descent into chaos that must be stopped, the 104th Congress saw it as federalism. As this Court has often pointed out, decentralized decisionmaking is one of the most salutary aspects of our federalist system of government. *Cf. Gregory v. Ashcroft*, 501 U.S. 452, 458 (1991) (noting that the "federalist structure of joint sovereigns" "allows for more innovation and experimentation in government"). The 104th Congress that passed the Telecommunications Act was keenly aware of the benefits that can come from keeping power in the hands of the States and thus called upon the state commissions -- which have regulated local telephone service for decades -- to play a central role in implementing the Act by conducting the case-specific

arbitrations that would lead to interconnection agreements. The States, after all, were in the best position to implement the Act in a manner that would not undermine the mechanisms used in each locality for promoting universal service.

In large part, the FCC simply assumes that there must be an overriding concern for producing a single, uniform application of the terms of the Act nationwide. Thus, the FCC and its supporters complain that under the Eighth Circuit's decision, the district court review process provided by Congress may take years before a completely uniform interpretation of the pricing provisions of the Act is achieved. The answer to this claimed infirmity in the decision is simple: the federal agency's obsession with rigid uniformity in results appears nowhere in the text of the statute. To the contrary, the Act relies primarily on private negotiations to establish interconnection agreements and frees such negotiated agreements from many of the specific requirements of the Act. *See* § 252(a). That rule obviously permits the widest imaginable variation in results. In addition, after assigning individual state commissions the task of conducting arbitrations, Congress provided for the most decentralized system of review possible -- review in the 93 federal district courts. *See* § 252(e)(6). Nothing about that system reveals a congressional concern with rapidly establishing a single, rigidly uniform application of the Act. To the contrary, Congress gave the States a vital role in implementing the Act precisely so that state commissions could use their localized experience to apply the Act to the varying circumstances in each of the fifty States.

That process of applying the Act, moreover, has long been underway. And while the FCC claims that it wants to speed implementation of the Act, it is actually further review of the FCC's claims to jurisdiction that will disrupt the steady progress the States have made in moving towards competition under the Act. Since the Eighth Circuit stayed the FCC's

pricing rules over a year ago, state commissions have proceeded rapidly with localized, case-specific arbitrations and have produced final interconnection agreements allowing new entrants to use incumbents' facilities, just as Congress intended. And despite the FCC's claims last fall that only it, and not the States, could be trusted to impose proper prices under the Act, as events have unfolded, the FCC has recently proclaimed that in fact "virtually every state" has followed the general approach adopted by the FCC and has required pricing based on forward-looking measures of cost. *See, e.g.* Reed Hundt, Chairman, FCC, remarks to the Chamber of Commerce, Washington, D.C. (May 29, 1997) ("[V]irtually every state in the Union has adopted our policies.").

Given the FCC's own assertions about the success its pricing theories have enjoyed in the States, the dire claims presented to this Court concerning the implementation of the Act ring rather hollow. Indeed, it seems clear that what is at stake here is not a battle over a fundamentally different pricing theory that will make or break competition in local telephone service, but rather a turf battle over whether or not a federal agency can augment its power so as to dictate every nuance of the pricing decisions state regulators must make under the Act.

Even if the Court were to grant review and even if it were somehow to conclude that the Eighth Circuit erred in its rulings on the FCC's jurisdiction over pricing, that decision would hardly lead to any speedier implementation of the local competition provisions of the Act. To the contrary, it would only produce lengthy rounds of additional litigation.

To begin with, GTE and other parties argued below that the FCC's pricing rules were invalid not only because the FCC lacked jurisdiction, but also because the substantive pricing standards violated the terms specified by Congress. On remand the Eighth Circuit would have to revisit the question of the substantive validity of the FCC's pricing rules. And given that the Eighth Circuit already has squarely concluded that the

proxy prices the FCC developed based on its pricing theories were likely to cause incumbents irreparable harm, there is a substantial possibility that the Eighth Circuit will strike down the FCC's pricing rules on the merits. In that event, the FCC would have to re-work its pricing approach before there could be any question of its rules ultimately being implemented by state commissions across the country.

Moreover, even if a set of pricing rules from the FCC were eventually approved in court, that would not mean that such rules could instantly be implemented. Since the Eighth Circuit stayed the FCC's pricing rules over a year ago, the States have been conducting arbitrations under their own interpretations of the Act's pricing provisions. Most of those arbitrations have produced final agreements that are now before district courts under the review provisions specified by Congress. *See* § 252(e)(6). Changing the applicable pricing rules now would mean suspending all of those district court actions, turning the clock back to the fall of 1996, and returning the arbitrated agreements to the States so that state commissions could re-work their pricing decisions to conform precisely to the FCC's rules. There is no reason to expect that this would be a speedy process. While most States have adopted many of the same basic approaches favored by the FCC, local variations in the details are plentiful -- just as Congress intended in allowing state commissions to use their local experience to implement the basic pricing standards of the Act. Even a slight change in the method used for determining the costs that underlie the cost-based pricing mandated by section 252(d)(2) could mean requiring the preparation of entirely new cost models, a process that could take many months of work.

In short, for well over a year, since the Eighth Circuit first stayed the FCC's pricing rules, the States have been laboring to implement the local competition provisions of the Act and have proceeded far along the path of using their own localized expertise to apply the pricing standards specified in section

252(d). The FCC, moreover, has publicly declared that the most critical aspects of its own pricing theories have been adopted across the country by the States acting independently. If this Court were to grant review now, the progress the States have made would be suspended and implementation of the Act would only be delayed.

II. The Eighth Circuit's Holding that Incumbent LECs Cannot Be Required to Provide Unbundled Elements Already Preassembled Into Platforms Was Plainly Correct, and in Any Event Involves Only Settled Principles of Statutory Construction.

The Court of Appeals' ruling that entrants may not obtain network elements already preassembled into fully operational service platforms also does not merit review for at least two reasons.

First, the holding was simply a correct application of standard rules of construction. The holding implements the clear directive in section 251(c)(3) that incumbents must provide "unbundled network elements in a manner that allows *requesting carriers to combine such elements*." (emphasis added). As the Eighth Circuit explained, this "sentence unambiguously indicates that requesting carriers will combine the unbundled elements themselves" -- incumbent LECs, in other words, have no duty to accomplish the combining for new entrants. Pet. App. 53a.

The Eighth Circuit's ruling on this point, moreover, was critical for maintaining a coherent interpretation of the obligations imposed on incumbents by the Act. GTE and other petitioners had argued that new entrants should not be allowed to provide local service *solely* through the purchase of unbundled elements because it would create opportunities for rampant arbitrage. As outlined above, given the prevailing interpretation that the pricing standards for wholesale service and for network elements were different, allowing entrants to

obtain all the elements needed for local service would simply allow them to obtain effectively the same thing as wholesale service, but at a different, lower price. Moreover, it would allow entrants to obtain the incumbent's finished service while completely evading any contribution toward universal service.

The Eighth Circuit did not agree entirely with either side on this issue. The Court ruled that an entrant could provide service solely through purchasing unbundled network elements, but it emphasized that its ruling would *not* result in the arbitrage GTE and others had feared. It was critical to the Court's analysis that, even though an entrant could effectively provide the incumbent's own finished service by means of purchasing network elements, purchasing elements would not be a simple substitute for purchasing wholesale service because it would require the entrant to assume much higher costs and risks. In particular, purchasers of elements would have to bear the costs and risks associated with *combining* the elements themselves. As the Court explained, "our decision requiring the requesting carriers to combine the elements themselves increases the costs and risks associated with unbundled access as a method of entering the local telecommunications industry *and simultaneously makes resale a distinct and attractive option.*" Pet. App. 56a-57a (emphasis added).

Allowing new entrants to obtain all of the network elements needed to provide service already combined together, however, "would obliterate the careful distinctions Congress has drawn in subsections 251(c)(3) and (4) between access to unbundled network elements on the one hand and the purchase at wholesale rates of an incumbent's telecommunications retail services for resale on the other." Order on Rehearing, Pet. App. 71a. As the Court recognized, obliterating that distinction would make no sense of the Act, and would simply allow the disastrous arbitrage that GTE and other LECs had feared.

Petitioners primarily argue that the Eighth Circuit misinterpreted the term "unbundled." All the ink petitioners

spill on the meaning of "unbundled" in other contexts, *see, e.g.*, FCC Pet. 26-27, AT&T Pet. 24-25, however, is entirely beside the point. Contrary to the picture petitioners would like to paint, the Court did not simply look at the term "unbundled" in isolation and produce the "unexplained assertion," AT&T Pet. at 23, that unbundled must mean "separated." Rather, the text of section 251(c)(3) makes it clear that Congress envisioned requesting carriers undertaking the burden of "combining" physically separated elements. Thus, whatever "unbundled" may mean in other contexts, read in the context of the sentence in which it appears in section 251(c)(3), it refers to pieces of the network that have been provided on a separated basis and which carriers can "combine." Moreover, as the Eighth Circuit explained, the burdens and risks associated with combining unbundled elements are essential for making sense of the overall structure of the Act since they preserve a vital distinction between purchasing unbundled elements and purchasing services for resale.

In short, the Eighth Circuit's ruling ensuring that incumbents will not be forced to provide new entrants with elements already pre-assembled into operational platforms not only implements the plain terms of section 251(c)(3) but is also necessary to preserve the distinction between network elements and resold service as separate methods of entry into the local market and to prevent new entrants from pocketing for themselves the very revenues that support universal service.

Second, as the above analysis suggests, the Eighth Circuit's decision to vacate the rule requiring incumbents to provide pre-assembled packages of elements was only one facet of its broader reading of the unbundling provisions of the Act. Thus, the Eighth Circuit ruled *in favor* of the FCC and other petitioners in determining both (i) that virtually all of the business functions of an incumbent LEC were network elements that must be provided to competitors and (ii) that an entrant could provide service *solely* through the purchase of an

incumbent's elements. As a result, if this Court were to reexamine the Eighth Circuit's ruling on the issue of pre-combined network element packages, it would necessarily require wading into a re-evaluation of the Court of Appeals' entire approach to understanding the unbundling duties required by the Act. To preserve its rights on these issues, GTE intends to file a conditional cross-petition for certiorari challenging both the Eighth Circuit's decision affirming the scope of the FCC's unbundling rules and its conclusion that new entrants can be allowed to provide local service solely through the use of unbundled network elements.

III. The Eighth Circuit's Decision to Vacate the "Pick and Choose" Rule Correctly Implements the Terms of the Act and Does Not Merit Review in this Court.

Petitioners' final claim is that the Eighth Circuit erred in striking down the FCC's rule purporting to implement section 252(i). That section provides that a "local exchange carrier shall make available any interconnection, service, or network element provided under an agreement . . . to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement." 47 U.S.C. § 252(i). The FCC ruled that under this section requesting carriers could "pick and choose" among individual provisions of interconnection agreements, selecting only the terms that seemed favorable to them and leaving others behind.

The Eighth Circuit rightly concluded that such an interpretation would undermine the process Congress outlined for implementing the Act and thus was not a reasonable reading of the text. Negotiating an interconnection agreement necessarily involves a process in which each party may make a concession on a particular point in return for a concession from the other party -- often on an unrelated part of the agreement. That bargaining process would be derailed, however, if after accepting one set of trade-offs in an agreement every new entrant would remain free to abandon

some terms of its deal and to pick out individual terms some other carrier had obtained -- terms unrelated to the particular bargains that had been struck in that entrant's own negotiations. In essence, agreements reached by negotiation would never actually be binding since a new entrant would always be free to jettison the trade-offs it had accepted and to cherry-pick favorable provisions found elsewhere. The Eighth Circuit was thus entirely correct in concluding that the FCC's construction was not a reasonable reading of the Act.

Petitioners claim that the Eighth Circuit misapplied the rule of *Chevron* by substituting its construction of an ambiguous provision for the FCC's. *See, e.g.*, AT&T Pet. at 29. That claim, however, mischaracterizes the Eighth Circuit's analysis. The Court fully acknowledged that "the language of subsection 252(i) in isolation does not clearly reveal Congress's intent," and, following *Chevron* precisely, explained that "we 'must look to the structure and language of the statute as a whole' to determine if the FCC's interpretation of this ambiguous provision is a reasonable one." Pet. App. 25a (quoting *National R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407, 417 (1992)). The Eighth Circuit reasonably concluded that given the emphasis in the Act on establishing a system of private negotiations, the FCC's expansive reading of section 252(i) would undermine the very process Congress had intended to be the primary means for implementing the local competition provisions of the Act.

In any event, even if the Eighth Circuit had erred in applying *Chevron* analysis, the fact-bound application of such a well-settled rule of law to the construction of a single section of a statute cannot justify review in this Court.

CONCLUSION

For the foregoing reasons, the petitions for certiorari should be denied.

Respectfully submitted,

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December 18, 1997

APPENDIX

EXCERPTS FROM *IN THE MATTER OF IMPLEMENTATION OF THE LOCAL COMPETITION PROVISIONS IN THE TELECOMMUNICATIONS ACT OF 1996*, FIRST REPORT AND ORDER, CC DOCKET NO. 96-98 (AUG. 8, 1996)

¶¶ 619, 628, 630-633, 685, 696

I. PRICING OF INTERCONNECTION AND UNBUNDLED ELEMENTS

A. Overview

[* * *]

619. While every state should, to the maximum extent feasible, immediately apply the pricing methodology for interconnection and unbundled elements that we set forth below, we recognize that not every state will have the resources to implement this pricing methodology immediately in the arbitrations that will need to be decided this fall. Therefore, so that competition is not impaired in the interim, we establish default proxies that a state commission shall use to resolve arbitrations in the period before it applies the pricing methodology. In most cases, these default proxies for unbundled elements and interconnection are ceilings, and states may select lower prices. In one instance, the default proxy we establish is a price range. Once a state sets prices according to an economic cost study conducted pursuant to the cost-based pricing methodology we outline, the defaults cease to apply. In setting a rate pursuant to the cost-based pricing methodology, and especially when setting a rate above a

default proxy ceiling or outside the default proxy range, the state must give full and fair effect to the economic costing methodology we set forth in this Order and must create a factual record, including the cost study, sufficient for purposes of review after notice and opportunity for the affected parties to participate.

[* * *]

B. Cost-Based Pricing Methodology

1. Application of the Statutory Pricing Standard

c. Discussion

628. Sections 251(c)(2) and (c)(3) impose an identical duty on incumbent LECs to provide interconnection and access to network elements "on rates, terms, and conditions that are just, reasonable, and nondiscriminatory."[1] In addition, both interconnection and unbundled network elements are made subject to the same pricing standard in section 252(d)(1). Based on the plain language of sections 251(c)(2), (c)(3), and section 252(d)(1), we conclude that Congress intended to apply the same pricing rules to interconnection and unbundled network elements. The pricing rules we adopt shall, therefore, apply to both.

[* * *]

2. Rate Levels

a. Pricing Based on Economic Costs

(1) Background

630. We observed in the NPRM that economists generally agree that prices based on forward-looking long-run incremental costs (LRIC) give appropriate signals to producers and consumers and ensure efficient entry and utilization of the

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[1] 47 U.S.C. § 251(c)(2), (c)(3)

telecommunications infrastructure.[2] We noted, however, that there was a lack of general agreement on the specifics of methodology for deriving prices based on LRIC or total service long-run incremental cost (TSLRIC). We invited parties to comment on whether we should require the states to employ a LRIC-based pricing methodology and to explain with specificity the costing methodology they support.[3] We recognized, however, that prices based on LRIC might not permit recovery of forward-looking costs if there were significant forward-looking joint and common costs among network elements.[4] We sought comment on how, if rates are set above incremental cost, to deal with the problems inherent in allocating common costs and any other overheads.[5] We observed that, by defining the unbundled elements at a sufficiently aggregated level, it may be possible to reduce the costs to be allocated as joint and common by identifying a substantial portion of costs as incremental to a particular element. To the extent that joint and common costs cannot be entirely eliminated, we sought comment on various methodologies for assigning them, including the use of a fixed allocator or on the basis of inverse demand elasticity. We also sought comment on whether, regardless of the method of allocating common costs, we should limit rates to levels that do not exceed stand-alone costs.[6] Finally, we invited parties to comment on whether a LRIC-based methodology would establish a price for interconnection and unbundled network

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[2] NPRM at para.124.

[3] *Id.* at para. 126.

[4] *Id.* at para. 129.

[5] *Id.* at para. 130.

[6] *Id.* For a definition of stand-alone costs, *see* Section VII.B.2.a. *infra*.

elements that includes a reasonable profit and thus complies with section 252(d)(1).[7]

631. A number of states already employ, or have plans to utilize, some form of LRIC or TSLRIC methodology in their approach to setting prices for unbundled network elements,[8] with several states choosing LRIC or TSLRIC as a price floor.[9] For instance, the Connection Commission adopted a TSLRIC methodology to measure the cost of service on SNET, its principal incumbent LEC.[10] Arizona also requires incumbent LECs to conduct TSLRIC costs studies to establish the

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[7] 47 U.S.C. § 252(d)(1)(A)(i); NPRM at para. 129.

[8] *See, e.g.*, California Commission comments at 29 (California has adopted TSLRIC as the standard for developing the costs of unbundled elements and in a rulemaking this summer will determine the unbundled network elements and what level of shared and common costs should be included in the price of each); Michigan Commission comments at 13 (1996 prices for loops to remain at levels established by the Michigan Commission in its original interconnection order or at TSLRIC); Texas Commission comments at 22 (Texas Commission has employed LRIC-based pricing methodologies for many years; SWBT and GTE required to file LRIC costs studies to be used in pricing not later than November 1, 1996).

[9] *See, e.g.*, Colorado Commission comments at Attachment (Rules Prescribing Principles for Costing and Pricing of Regulated Services of Telecommunications Service Providers) 4 CCR 723-30, Rules 4-5; Hawaii Administrative Rules, Sections 6-80-32-34 (setting out a three-tiered pricing regime with TSLRIC set as floor for pricing of competitive services); Louisiana Commission comments at Attachment (Louisiana Public Service Commission "Regulations for Competition in the Local Telecommunications Market"), p. 30; Washington Commission comments at 25, Appendix B (*Washington Utilities and Transportation Commission v. U S West Communications*, Docket No. UT-950200 at 82 (Washington Commission, April 11, 1996)); Wisconsin Stat. Ann. section 196.204 (requiring the price of each network service or function to exceed TSLRIC).

[10] Connecticut Commission comments at 4.

underlying cost of unbundled services and facilities.[11] The Ohio Commission has adopted Long Run Service Incremental Cost ("LRSIC") , which is closely related to TSLRIC.[12] The Missouri and Wyoming Commissions are among a number of state commissions that have not yet adopted a pricing methodology, but are considering LRIC or TSLRIC.[13] Oklahoma law provides for submission of LRIC cost studies and studies identifying a contribution to common costs for interconnection of facilities and access to network elements to the Oklahoma Commission during an arbitration.[14] A number of states have yet to choose a pricing methodology. For instance, the New York Commission sets prices on a case-by-case basis.[15] Unbundled element prices also exist in several states pursuant to negotiated interconnection agreements that

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[11] Arizona Commission comments, Exhibit V (Arizona Administrative Code R14-2-1101 *et seq.*), p. 10.

[12] See, Ohio Commission comments at 43-45.

[13] *See, e.g.*, Missouri Commission comments at 11 (supports LRIC for costing; LRIC is defined in pending state legislation); Wyoming Commission comments at 26-27 (draft rules propose use of TSLRIC as a price floor, with prices to include a contribution to shared, common, and joint costs, and the sum of prices for unbundled elements not to exceed retail for bundled services; incumbent LECs shall impute the prices of unbundled elements into the price floors of each of their own services that utilize the network elements).

[14] Oklahoma Commission comments at appendix A (Corporation Commission Telephone Rules OAC 165:55-17-25), pp.10-11.

[15] *Competition, The State Experience* at 80 (compilation of written responses by state commission staffs to questions by FCC staff, compiled by NARUC) (March 8, 1996).

have either already been approved by state commissions or are under consideration.[16]

632. Section 252(d)(1) requires, *inter alia*, that rates for interconnection and unbundled network elements be based on "cost (determined without reference to a rate-of-return or other rate-based proceeding)."[17] We tentatively concluded in the NPRM that this language precludes states from setting rates by use of traditional cost-of service regulation, with its detailed examination of historical carrier investment and expenses.[18] Instead, we indicated our belief that the statue contemplates the use of other forms of cost-based price regulation, such as the setting of prices based on forward-looking economic cost methodologies (such as LRIC) and do not involve the use of an embedded rate base. We sought comment on whether section 252(d)(1) forecloses consideration of historical or embedded costs or merely prohibits state commissions from conducting a traditional rate-of-return proceeding to establish prices for interconnection and unbundled network elements. Embedded costs are the costs that the incumbent LECs carry on their accounting books that reflect historical purchase prices,

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[16] According to information in our possession, such agreements have been negotiated in, among other states, Alabama, Florida, Georgia, Kentucky, Illinois, Louisiana, Mississippi, North Carolina, South Carolina, and Tennessee. Letter from W.W. Jordan, Executive Director--Federal Regulatory, BellSouth, to William F. Caton, Acting Secretary, July 11, 1996 at Attachment (containing chart detailing agreements between BellSouth and new entrants in Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, and Tennessee); "Interconnection Agreement Under Sections 251 and 252 of the telecommunications Act of 1996, by and between, Ameritech Information Industry Services and MFS Intelenet of Illinois, Inc.," dated May 17, 1996 (filed July 25, 1996).

[17] 47 U.S.C. § 252(d)(1)(B).

[18] NPRM at para. 123.

regulatory depreciation rates, system configurations, and operating procedures. We invited parties to comment on whether incumbent LECs should be permitted to recover some portion of their historical or embedded costs over TSLRIC.[19]

633. In the NPRM, we noted that certain incumbent LECs had advocated that interconnection and access to unbundled element prices be based on the "efficient component pricing rule" (ECPR).[20] Under this approach, an incumbent LEC that sells an essential input element, such as interconnection, to a competing network would set the price of that input element equal to "the input's direct per-unit incremental costs plus the opportunity cost to the input supplier of the sale of a unit of input."[21] We tentatively concluded in the NPRM that ECPR or equivalent methodologies are inconsistent with the section 252(d)(1) requirement that rates be based on "cost," and we proposed to preclude the states from using this methodology.[22]

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(3) Discussion

(a) Total Element Long Run Incremental Cost

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[19] *Id.* at para. 129.

[20] *Id.* at para. 147. *See* William J. Baumol, *Some Subtle Issues in Railroad Deregulation*, 10 Int'l J. Trans. Econ. 341 (1983); William Baumol & Gregory Sidak, *Toward Competition in Local Telephony* (1994); William Baumal & Gregory Sidak, *The Pricing of Inputs Sold to Competitors*, 11 Yale J. on Reg. 171 (1994).

[21] William Baumol & Gregory Sidak, *The Price of Inputs Sold to Competitors*, 11 Yale J. on Reg. 171, 178.

[22] NPRM at para. 148.

685. Under the third approach, prices for interconnection and access to unbundled elements would be developed from a forward-looking economic cost methodology based on the most efficient technology deployed in the incumbent LEC's current wire center locations. This approach mitigates incumbent LECs' concerns that a forward-looking pricing methodology ignores existing network design, while basing prices on efficient, new technology that is compatible with the existing infrastructure. This benchmark of forward-looking cost and existing network design most closely represents the incremental costs that incumbents actually expect to incur in making network elements available to new entrants. Moreover, this approach encourages facilities-based competition to the extent that new entrants, by designing more efficient network configurations, are able to provide the service at a lower cost than the incumbent LEC. We, therefore, conclude that the forward-looking pricing methodology for interconnection and unbundled network elements should be based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that the reconstructed local network will employ the most efficient technology for reasonably foreseeable capacity requirements.

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696. We conclude that forward-looking common costs shall be allocated among elements and services in a reasonable manner, consistent with the pro-competitive goals of the 1996 Act. One reasonable allocation method would be allocate common costs using a fixed allocator, such as a percentage markup over the directly attributable forward-looking costs. We conclude that a second reasonable allocation method would allocate only a relatively small share of common costs to certain critical network elements, such as the local loop and collocation, that are most difficult for entrants to replicate promptly (*i.e.*, bottleneck facilities). Allocation of common costs on this basis ensures that the prices of network elements

that are least likely to be subject to competition are not artificially inflated by a large allocation of common costs. On the other hand, certain other allocation methods would not be reasonable. For example, we conclude that an allocation methodology that relies exclusively on allocating common costs in inverse proportion to the sensitivity of demand for various network elements and services may not be used.[23] We conclude that such an allocation could unreasonably limit the extent of entry into local exchange markets by allocating more costs to, and thus raising the prices of, the most critical bottleneck inputs, the demand for which tends to be relatively inelastic. Such an allocation of these costs would undermine the pro-competitive objectives of the 1996 Act.

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[23] *See* Frank P. Ramsey, *A Contribution to the Theory of Taxation*, 37 Econ. J. 47 (1927); *see generally* Kenneth E. Train, *Optimal Regulation: The Economic Theory of Natural Monopoly* 115-40 (1992) (discussing efficiency properties of Ramsey prices); Bridger M. Mitchell & Ingo Vogelsang, *Telecommunications Pricing: Theory and Practice* 43-61 (1991). The sensitivity of demand is measured by the elasticity of demand, which is defined as the percentage change in the quantity of a service demanded for a one per cent change in price.